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**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

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**FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY**

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In the Matter of )  
)  
)

Petition of Ameritech Corporation )  
for Forbearance from Enforcement )  
of Section 275(a) )  
)  
\_\_\_\_\_ )

CC Docket No. 98-65

To: The Commission

**PETITION FOR RECONSIDERATION**

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## **SUMMARY**

The Commission should reconsider its *Section 275(a) Forbearance Order* and grant Ameritech's Petition for Forbearance from enforcement of Section 275(a). Specifically, it should reconsider its decision to interpret Section 10(b) of the Telecommunications Act of 1996 as imposing an obligation on a party seeking forbearance to demonstrate that circumstances have changed since the enactment of the statutory provision from which it seeks forbearance. No such requirement is created by Section 10(b). Indeed, had Congress in the 1996 Act imposed this extraordinary requirement, it would have done so explicitly. In the absence of such statutory language, the Commission should not create additional barriers. Moreover, none of the Commission's prior forbearance cases imposed such a requirement, and the orders in several of those cases are logically inconsistent with the Commission's rationale and decision in this proceeding .

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To: The Commission

**PETITION FOR RECONSIDERATION**

Pursuant to Part 1.106 of the Commission's rules, Ameritech Corp.

("Ameritech") submits this Petition for Reconsideration of the issue decided by the Commission in its Report and Order ("*Section 275(a) Forbearance Order*") released in the above-captioned docket on August 31, 1999 and not yet published in the Federal Register. The *Order* denied Ameritech's petition for forbearance from the application to Ameritech of Section 275(a) of the Communications Act of 1934 (the "Communications Act"), as amended by the Telecommunications Act of 1996 (the "1996 Act").<sup>1</sup> Ameritech requests that the

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<sup>1</sup> 47 U.S.C. § 275(a); Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (codified as amended at 47 U.S.C. § 151).

Commission reconsider its decision in the *Order*, and grant in full or in part Ameritech's petition for forbearance.

I. The Commission Incorrectly Interpreted Section 10(b) to Require a Showing of New or Changed Circumstances

In the *Section 275(a) Forbearance Order*, the Commission denied Ameritech's petition for forbearance because it found that Ameritech had not satisfied the public interest prong of the three part forbearance test set out in Section 10(a).<sup>2</sup> Specifically, it concluded that Ameritech had failed "to present any *new or unanticipated circumstance* that might have persuaded Congress to adopt an earlier sunset date" for Section 275(a)'s prohibition of acquisitions of alarm monitoring entities prior to February 2001.<sup>3</sup> This "changed circumstance" test has no basis in either the text of Section 10 or Commission precedent, and is contrary to principles of statutory construction. The Commission should grant this petition for reconsideration and apply the correct statutory test.

A. Section 10 Does Not Impose or Support a "Changed Circumstance" Test

The Commission ignored the plain language of Section 10 when it adopted a test requiring that a petitioner for forbearance demonstrate the existence of "new or unantici-

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<sup>2</sup> *In re Petition of Ameritech Corporation for Forbearance from Enforcement of Section 275(a) of the Communications Act, As Amended*, Memorandum Opinion and Order, CC Docket No. 98-65 (August 31, 1999) ("*Section 275(a) Forbearance Order*"). Section 10 is codified at 47 U.S.C. § 160.

<sup>3</sup> *See Section 275(a) Forbearance Order* at ¶ 9 (emphasis added).

pated" (i.e., changed) circumstances. It is, of course, a fundamental canon of statutory construction that an agency charged with interpreting a statute should look first to the plain language of the statute to determine its meaning.<sup>4</sup>

Section 10(a) sets forth a three part test for determining when the Commission is required to forbear from applying a provision of the Communications Act to a telecommunications carrier. Section 10(a)(3), the subsection on which the Commission relied in denying Ameritech's Petition for Forbearance, provides that the Commission shall determine whether "forbearance from applying such provision or regulation is consistent with the public interest." Section 10(b) further requires that:

In making the determination under subsection (a)(3), the Commission shall consider whether forbearance from the provision or regulation will promote competitive market conditions, including the extent to which such forbearance will enhance competition among providers of telecommunications services. . . .

As Commissioner Powell noted in his dissent,<sup>5</sup> nothing in the language of Section 10(a)(3) or 10(b) indicates that the Commission is permitted or required to determine the existence of changed circumstances before applying the statutory forbearance test, much less that it can forbear only when a petitioner has demonstrated that there are new or

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<sup>4</sup> See, e.g., Landreth Timber Co. v. Landreth, 471 U.S. 681, 685 (1985); Board of Governors of the Federal Reserve System v. Dimension Financial Corp., 474 U.S. 361, 368 (1986). "If the statute is clear and unambiguous, 'that is the end of the matter, for . . . the agency must give effect to the unambiguously expressed intent of Congress.'" Id. (quoting Chevron U.S.A. Inc., v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-843 (1984)); see also Richards Medical Co. v. United States, 910 F.2d 828, 830 (Fed. Cir. 1990) (in questions of statutory construction, the Court starts first with the plain meaning of the statute).

<sup>5</sup> *Section 275(a) Forbearance Order*, dissent of Cmr. Powell, at 2 .

changed circumstances. To the contrary, both the clear language of Section 10 and the Commission's decisions applying the provision confirm that "section 10 mandates forbearance if the statutory criteria are met."<sup>6</sup> With the exception of requests to forbear from application of Sections 251(c) and 271 (discussed in the next section), the existence of changed circumstances is simply not a relevant consideration in the statutory scheme.

B. The Structure of The 1996 Act Demonstrates that Congress Did Not Intend to Create a "Changed Circumstances" Test for Section 275(a)

The Commission's decision to require changed circumstances is also inconsistent with the statutory structure of the 1996 Act. In enacting Section 10, Congress made the judgment that the best way to ensure that the provisions of either the Communications Act (including the 1996 Act) or the Commission's own regulations did not inadvertently stifle competition was to require that the Commission forbear from applying its regulations or any provision of the Communications Act where enforcement is unnecessary.<sup>7</sup> The only exception to the broad forbearance power granted in Section 10(a) is spelled out in Section 10(d), which states that "except as provided in section 251(f), the Commission may not

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<sup>6</sup> *In the Matters of Bell Operating Companies Petitions for Forebearance from the Application of Section 272 to Certain Activities*, 13 FCC Rcd. 2627, 2643 (1998) ("Section 272 Forbearance Order"); see also *In the Matters of Nevada Bell, Pacific Bell and Southwestern Bell Telephone Company Petitions for Forebearance from the Application of Section 272 to Reverse Search Services*, 14 FCC Rcd. 6329, 6331 (1999) ("Reverse Directory Services Forbearance Order").

<sup>7</sup> Conference Report 104-458, 104<sup>th</sup> Cong., 2d Sess. at 184-185, *reprinted in* 1996 U.S.S.C.A.N. 124, 197-198.

forbear from applying the requirements of sections 251(c) or 271 . . . until it determines that those requirements have been fully implemented." In other words, Congress did create an explicit changed circumstances test, but only for two of the provisions of the 1996 Act - Sections 251(c) and 271. For those provisions, and those provisions alone, Congress concluded that the public interest in creating competitive local exchange markets would so outweigh any other considerations as to preclude any possibility of forbearance before circumstances had changed sufficiently, i.e., before the requirements of those sections were fully met.

The fact that Congress created a specific changed circumstances test for two provisions but not for Section 275 is further clear evidence, although none is needed, that it did not intend the Commission to apply such a test to requests to forbear from the application of Section 275(a).<sup>8</sup> Rather, for all pre-existing provisions of the Communications Act and all provisions of the 1996 Act other than Sections 251(c) and 271, Congress intended that the Commission determine whether forbearance is warranted by applying the three-pronged test

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<sup>8</sup> It is a well established principle of statutory interpretation that "[w]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." United States v. Gonzales, 520 U.S. 1, 5 (1997) (citing Russello v. United States, 464 U.S. 16, 23 (1983)); *see also* Gozlon-Peretz v. U.S., 498 U.S. 395, 404 (1991); INS v. Cardozo-Fonseca, 480 U.S. 421, 432 (1987); Independent Bankers Assoc. of America v. Farm Credit Administration, 164 F.3d 661, 667 (D.C. Cir. 1999); Alabama Power Co. v. FERC, 160 F.3d 7, 14 (D.C. Cir. 1998).



of Section 10(a), as supplemented by Section 10(b).<sup>9</sup> It is axiomatic that the Commission's authority is limited to that which is authorized by statute to do.<sup>10</sup> The application of a changed circumstances test is not authorized by Section 10 or any other provision of the statute.

C. The *Order* Is Inconsistent With Commission Precedent

Both the decision and the reasoning adopted by the Commission are inconsistent with numerous Commission decisions applying Section 10 in the last three years. The *Order's* asserted reliance on the Section 10(a)(3) "public interest" test is a transparent attempt to clothe the newly created test with a fig leaf of statutory legitimacy. The *Order* assumes that the status quo of the Congressional judgment embodied in Section 275(a) *is* "the public interest" and places the burden on the petitioner to demonstrate that this judgment no longer reflects the public interest.<sup>11</sup> In effect, the Commission is ignoring the language of Section 10 and Congress's judgment by declining to undertake the analysis that Congress directed the Commission to undertake in Section 10.

If the Commission is correct in assuming that Section 275(a) embodies Congress's judgment about the public interest and how best to promote competition in the

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<sup>9</sup> Conference Report 104-458, 104<sup>th</sup> Cong., 2d Sess. at 185, *reprinted in* 1996 U.S.S.C.A.N. 124, 198.

<sup>10</sup> FCC v. American Broadcasting Co., 347 U.S. 284, 296 (1954).

<sup>11</sup> *Section 275(a) Forbearance Order* at ¶ 7.

alarm monitoring industry,<sup>12</sup> then the same must also by definition be true of every other provision in the 1996 Act – with each provision, Congress made judgments about how best to promote competitive conditions in affected communications markets. Nonetheless, the Commission has never made this assumption in any of the numerous previous orders in which it has addressed requests that it forbear from applying specific provisions of the 1996 Act. In none of the cases, even those denying requests for forbearance, has the Commission ever assumed that an existing provision embodies the public interest, nor has it required petitioners to demonstrate that circumstances have changed since 1996 or to provide the type of evidence that (in the Commission's view) would have convinced Congress in 1996 to change the language of the specific provision at issue. Rather, in those prior cases the Commission has examined the public interest, including competitive market conditions, *de novo* as required by the statute. In fact, the granting of forbearance in at least two of these cases was demonstrably inconsistent with the changed circumstances test applied in the *Section 275(a) Forbearance Order*.

For example, in the *Section 272 Forbearance Order* the Commission considered requests to forbear from applying Section 272 of the 1996 Act (which requires structural separation for RBOC affiliates engaged in certain interLATA activities including, *inter alia*, E911 services).<sup>13</sup> The Commission decided to forbear from application of Section 272 to E911 services because requiring structural separation would "impose substantial costs

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<sup>12</sup> *Section 275(a) Forbearance Order* at ¶ 9.

<sup>13</sup> *Section 272 Forbearance Order*, 13 FCC Rcd. at 2641-2643; 2650-2653.

without increasing the quality of those services."<sup>14</sup> The Commission did not require any showing of new or changed circumstances. Had it done so, it could not have granted the petition for forbearance, for it was indisputable that there were no new circumstances: in 1998, RBOCs were providing E911 services on the same non-separated basis as they had been providing such services for years prior to the enactment of Section 272 and Congress had been aware of the nature of these E911 arrangements when it enacted Section 272 in 1996.<sup>15</sup> For purposes of a Section 10(a)(3) public interest analysis, there is no legally defensible basis to distinguish between the Congressional decision inherent in Section 272 and that inherent in Section 275(a).

Similarly, in the *Reverse Directory Services Forbearance Order*, SWBT requested that the Commission forbear from application of the Section 272(a) separate affiliate requirements to its reverse directory services activities.<sup>16</sup> Again, no showing of changed circumstances was either made or required.<sup>17</sup> Rather, the Commission correctly applied the test in Section 10(a) and, relying largely on the *Section 272 Forbearance Order*, granted the petition for forbearance.

The *CMRS Forbearance Order*, the only forbearance precedent cited in the *Section 275(a) Forbearance Order*, is also inconsistent with the latter *Order*. The *CMRS*

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<sup>14</sup> Id. at 2646, 2650.

<sup>15</sup> Id. at 2636-2637; 2652-53.

<sup>16</sup> *Reverse Directory Services Forbearance Order*, 14 FCC Rcd. at 6332-6334.

<sup>17</sup> Id.

*Forbearance Order* involved Section 254(g), which was amended in the 1996 Act and which requires carriers to maintain rate integration.<sup>18</sup> In the *CMRS Forbearance Order*, the Commission did not proceed from the assumption that the choices Congress had made in enacting Section 254(g) in 1996 established the "public interest;" rather, it properly focused its analysis on the three Section 10(a) factors, including whether forbearance was in the public interest because it would promote competitive market conditions. After examining the entire record before it in light of the statutory factors, the Commission found that petitioners had failed to demonstrate that forbearance would help attain the intended benefits of Section 254(g).<sup>19</sup> In fact, the Commission conducted the analysis required by Section 10(b) and explicitly found "no persuasive record evidence" that forbearance would promote competitive market conditions.<sup>20</sup> In contrast, Ameritech here provided substantial evidence that forbear-

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<sup>18</sup> *In re Policy and Rules Concerning the Interstate Interexchange Marketplace, Memorandum Opinion and Order*, 14 FCC Rcd 391 (1998) ("*CMRS Forbearance Order*"); cited in the *Section 275(a) Forbearance Order* at 5.

<sup>19</sup> *CMRS Forbearance Order* at ¶¶ 31-34. In reaching this conclusion, the Commission did not suggest a need for any showing of "changed circumstances." Moreover, no such showing could have been made, since the practices and competitive conditions at issue pre-dated the 1996 revision to Section 254(g). *Id.* at ¶¶ 34-35.

<sup>20</sup> *CMRS Forbearance Order* at ¶ 34. The *CMRS Forbearance Order* does support the proposition that "a petitioner must explain how the benefits of a statutory provision can be attained in the event of forbearance." *Section 275(a) Forbearance Order* at ¶ 7. However, Ameritech specifically made such a showing here (*see* Forbearance Petition at 10-27), and that should have been sufficient under the *CMRS Forbearance Order*.

ance would promote competitive market conditions, with not even a theoretical possibility of anticompetitive consequences in most of the 50 states.<sup>21</sup>

Because the *Section 275(a) Forbearance Order* is inconsistent with the Commission's prior decisions under Section 10, reconsideration is warranted.

II. Even if Congress Intended to Require a Showing of Changed Circumstances, Such a Showing Was Made Here

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Even if Section 10 did incorporate a Congressional requirement that the Commission forbear from enforcing a statute only if new or unanticipated circumstances had occurred in the years since the provision at issue was enacted, such circumstances exist here. The overarching purpose of Section 275 was to benefit the owners of small alarm monitoring businesses in the highly fragmented alarm monitoring industry, largely by insulating them from competition with large companies.<sup>22</sup> In the three and one-half years since the provision was enacted, circumstances in the industry have changed substantially. First, the industry has been undergoing a market consolidation resulting in the presence of very large companies in the market. Therefore enforcing Section 275(a) will not insulate small alarm companies from competition with large companies. Such competition from the likes of ADT is already

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<sup>21</sup> See Forbearance Petition at 21-27.

<sup>22</sup> Indeed, one of Congress's principal concerns was that big companies like the RBOCs would harm competition and upset the "level playing field in the "small business dominated alarm industry." See H.R. Rep. No. 240(i), 104th Cong., 1st Sess. 237-38 (1995); see also 141 Cong. Rec. S8355-56 (June 14, 1995) (statement by Senator Harkin).

present. In fact, enforcement of Section 275(a) will hurt the small companies rather than benefit them.

At the time Congress was considering the bill in 1995, no single competitor had as much as 10 percent of the market. After the 1996 Act became law, a number of relatively large companies, including Entergy, Wells Fargo and AlarmGuard, began purchasing the assets or operations of smaller alarm monitoring operators. Moreover, two very large players, Tyco International, Inc. (through its subsidiary ADT) and Western Resources, Inc. (through its subsidiary Protection One), have gone on acquisition binges which together have given them over 25 percent of the domestic U.S. market in alarm monitoring services.<sup>23</sup>

The consolidation trend was a factor completely unanticipated by Congress. It cannot be stopped, nor should it be, by the Commission. The Commission may and should, however, take the growing consolidation into account in determining whether changed circumstances exist. In particular, the Commission should consider the effect of the trend on the goal of Section 275(a) - benefitting small alarm businesses. Information widely available in the alarm monitoring industry indicates that it is a buyer's market -- many small alarm monitoring entity owners wish to sell.<sup>24</sup> Yet, as a consequence in part of recent consolidations of large regional players, particularly ADT's purchases of the alarm monitoring operations of Entergy and AlarmGuard, there has been "a decline in the number of active

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<sup>23</sup> Since April 1998, just weeks before Ameritech's forbearance petition was filed, ADT has purchased Entergy, Wells Fargo and AlarmGuard, effectively removing them as potential competing acquirors.

<sup>24</sup> *Security Alarm Market Value Watch*, Spring 1999 at 1 (Attachment A).

large corporate buyers in the market."<sup>25</sup> The inevitable result is that the per-customer prices paid to owners of alarm monitoring businesses have fallen dramatically since late 1997.<sup>26</sup> In other words, Section 275(a), by eliminating Ameritech as a potential buyer, is harming the ability of smaller alarm monitoring business owners to obtain fair value for the businesses they wish to sell. Evidence of this trend, provided in Attachment A hereto, was not available to Ameritech at the time it filed its petition for forbearance.<sup>27</sup>

The second changed circumstance is that one of the scenarios that prompted Congress to enact Section 275(a) – the possibility that an RBOC might have the ability to discriminate *successfully* against competing alarm monitoring service providers through its control of the local loop "bottleneck" – has simply failed to materialize. In the three and a half years since the enactment of the 1996 Act, there has not been a single instance where a competing alarm monitoring provider has even alleged that Ameritech has engaged in discriminatory or anticompetitive conduct against it, much less any such conduct involving its local exchange facilities (including the local loop). Thus, one of the dangers that the section was designed to prevent is not a concern.

Either of these factors constitutes a new or changed circumstance. Once the Commission considers the new evidence in the record, it should find that each factor alone,

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<sup>25</sup> *Security Alarm Market Value Watch*, Summer 1999 at 1 (Attachment A).

<sup>26</sup> *Id.* at 1, 4-5; *see also Security Alarm Market Value Watch*, Spring 1999 at 1 (Attachment A).

<sup>27</sup> *Cf.* 47 C.F.R. § 1.106(b)(2) (recognizing new facts as grounds for reconsideration in rulemaking).


and certainly both together, constitute changed circumstances which warrant revisiting the request to forbear from the application of Section 275(a) to Ameritech.

**CONCLUSION**

For the foregoing reasons, the Commission should grant this petition for reconsideration and apply the statutory test set forth in Section 10. Once it applies the forbearance test properly to the complete record before it, the Commission should determine that forbearance is appropriate.

Respectfully submitted,

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Dated: September 30, 1999



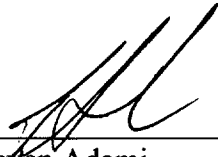
### **CERTIFICATE OF SERVICE**

I hereby certify that on this 30<sup>th</sup> day of September, 1999, copies of the foregoing Petition for Reconsideration were served by pre-paid, first class U.S. mail or hand delivery\* on the following:

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\_\_\_\_\_  
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# **Attachment A**

# SECURITY ALARM MARKET VALUE WATCH

No. 2

QUARTERLY UPDATE

SUMMER 1999

## Market Softens in 1999

Expected early-year correction occurs ...  
but how far will it go?

In tabulating the early 1999 transaction data, there were few surprises. As predicted, the market softened with market valuations declining on average. The declines affected virtually every market segment, with the public equity market valuations realizing the biggest hits.

The valuation adjustments were not however as large as many expected, although it is important to keep in mind that for private acquisition transactions and dealer program activity, only the first quarter data has been processed. Early indications of second quarter data indicate that the softening will continue gradually. First quarter overall market values declined by 5.5% from overall averages in the 4th quarter of 1998. Dealer pricing (adjusted for changes in other terms) declined by somewhere between 3% and 4% over the same period. The surprise, and a strong

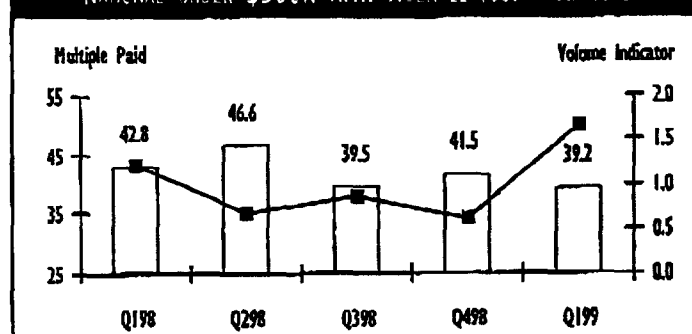
indicator that additional softening will occur, is the across the board increase in the volume of activity. Both company acquisitions and dealer program activity increased sharply over the prior quarter. If the sell side of the market were not willing to accept the lower bids, one would expect a decline in activity. Valuations will probably continue to slip until significant seller resistance is felt, and the number of transactions decline.

It is likely that two factors will play against each other for the remainder of the year ... and into Y2K. The first, a decidedly "bearish" force, is the decline in the number of active large corporate buyers in the market. Protection One has lowered their appetite for bulk acquisitions, Ameritech is effectively sidelined, and Entergy and AlarmGuard have exited the business. This leaves ADT and a host of other players, but still a significant decline in the depth in the buy side of the market. The second "bullish" factor is the inherent structure of the market ... that is, it's high degree of fragmentation. Assuming there is continued interest in growth and consolidation efforts, acquisitions will continue to be on the critical path to success, and the effort will have to move down market, which is

where most of the overall market valuation declines have occurred.

The data currently suggests that the bear factor will be dominant throughout the remainder of the year, except in the largest company size segments. The bull should regain ground as fewer large transactions are to be had, and the pressures for continued growth occur. This will be supported by an increase in large regional buyer activity as prices decline towards their target range. The entrance of another significant

NATIONAL UNDER \$500K RMR MULTIPLE-VOLUME ANALYSIS



player could accelerate a stabilizing or rebound in values. The market should keep their eyes on Honeywell and Brinks ... both of who may decide it is time to sell or begin acquiring.

This issue analyzes the national and regional data in detail, in the following section. The Commentary section looks at the economics and some of the mechanics of dealer program pricing. It also addresses the industry's fragmented structure and its barriers to consolidation. This is followed by a closer look at the public stocks ... it looks like this could be a good time to buy.

We also changed a few things in this issue, most notably the chart appearing on the cover ... our primary market indicator ... which is explained on page 7.

### THIS QUARTER:

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#### ANALYSIS

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COMMENTARY ..... 17

PUBLIC COMPANIES ... 21

## ANALYSIS

## Bear Market Sentiment

### Values slip in high activity

Overall, the market for early 1999 appeared to soften with average market values declining in bulk acquisition transactions, dealer program account purchases, and public alarm company stock valuations. This, combined with an exit of the industry by two large regional consolidators (Entergy and

AlarmGuard), the general feeling is that the market is

#### NATIONAL OVERVIEW

heading into a "bear" cycle. The numbers reflect valuation declines but surprisingly not to the extent the conventional wisdom suggests, particularly given the appearance of some fairly material sell-side pressure reflected in the big jump in the number of acquisition transactions.

The number of deals across the nation for this period were up almost 50% over the same quarter in the prior year, and up even more compared to the preceding three quarters. Chart 1 indicates this increase in transaction volumes, and also reflects the decrease in average market values to a 39 multiple of RMR. This average value is approximately 8% lower than the first quarter of the prior year, and off over 15% from the market's peak in the second quarter of 1998.

The material increase in transaction volume coupled with declining prices appears to signal a shift towards a supply side, or sellers driven market. As there does not appear to be a significant change in the overall operating environment, the increase in sellers would seem to be an indication of a "bear" market sentiment on the part of alarm company owners who were considering a sale. The volume indicator is influenced slightly by the inclina-

tion of sellers to postpone transactions into the following tax year, but even adjusting for this effect, the number of transactions is up significantly. The lower number of transactions in the prior three quarters coupled with generally declining prices indicates that there may have been a significant gap between the,

CHART 1: NATIONAL UNDER \$500K RMR MULTIPLE-VOLUME ANALYSIS

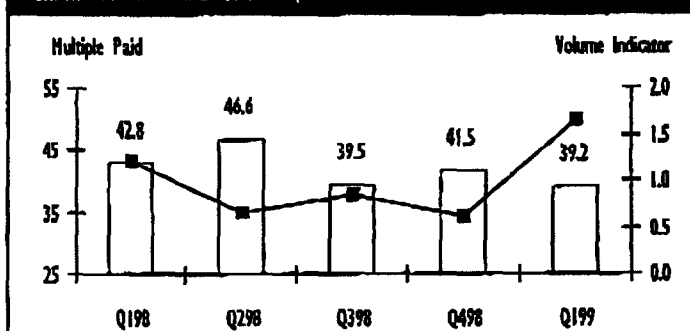
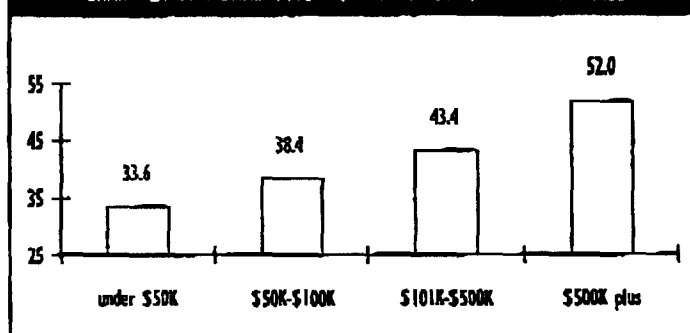


CHART 2: NATIONAL MULTIPLES PAID BY TRANSACTION SIZE



## SECURITY ALARM MARKET VALUE WATCH

## SECTION TWO - ANALYSIS

CHART 3: NATIONAL UNDER \$50K RMR MULTIPLE-VOLUME ANALYSIS

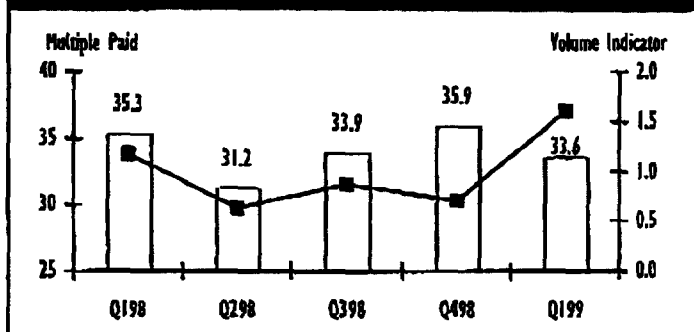


CHART 4: NATIONAL \$50K-\$100K RMR MULTIPLE-VOLUME ANALYSIS

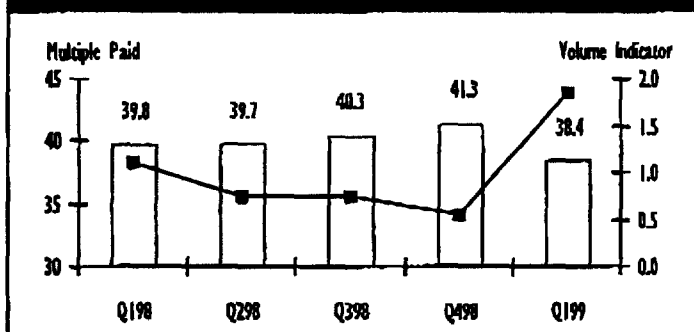


CHART 5: NATIONAL \$101K-\$500K RMR MULTIPLE-VOLUME ANALYSIS

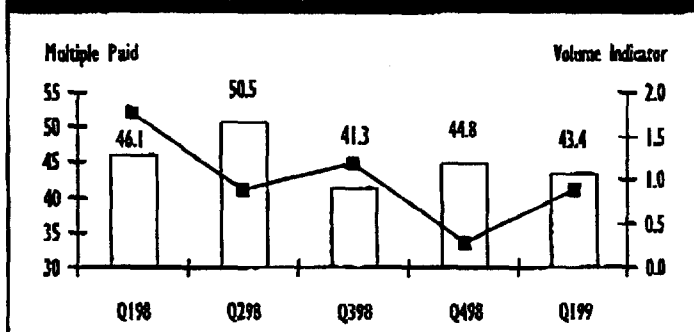
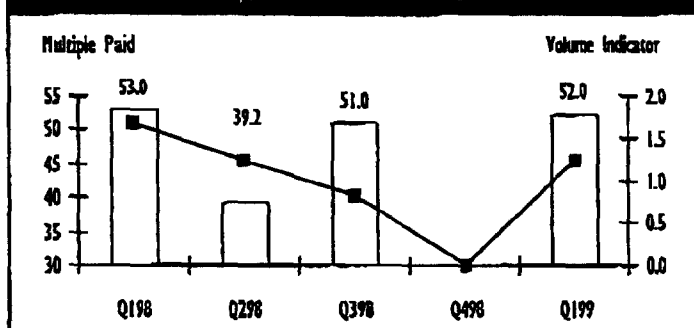


CHART 6: NATIONAL \$500K PLUS RMR MULTIPLE-VOLUME ANALYSIS



offering price by buyers and the expected/asking price on the part of potential sellers. When this "bid-ask" spread widens too far, the number of transactions consummated typically declines. The first quarter results (coupled with early indicators of second quarter results) appear to indicate a narrowing of this spread, as sellers begin to accept that average market values are lower.

#### Transaction Size

With an increase in activity, the market became more consistent in valuing alarm companies ... at least by size. As indicated in Chart 2, there was a steady increase in average market values by the four specified size categories. While it is possible that larger operations may many times be inherently more valuable to buyers through some combination of higher post-consolidation efficiencies and/or lower relative transaction and integration costs, this step-up is predominantly a "scarcity premium." That is, at any given time there are more companies for sale in the smaller size categories due to the industry's high fragmentation. (See page 19 of the Commentary section, "Industry Consolidation: A Big Job Ahead.") As long as buyers are seeking consolidation, increased market-share, and growth, the larger acquisition opportunity will represent a quicker and many times more predictable path towards these goals. This should result in continued vigorous interest in the larger enterprises, and resulting higher relative market valuations.

Chart 3 indicates the relative changes in average market valuations for transactions involving under \$50K of RMR. As was the case with the overall national averages, transaction volumes increased significantly to their highest levels, while prices dropped over 6% from their high point in Q498. Interestingly, the entire price decline was due to a very significant drop in average prices in the South region of the U.S. Average values in this size category actually increased for all other regions of the country. The South, however, is where a very large percentage of deals in this transaction size occurred and the average price fell by almost 17% (See South section beginning on page 12), which overwhelmed the increases elsewhere.

This is in contrast to the averages for transactions involving sellers with between \$50K-\$100K of RMR, where in every region of the country prices fell. As indicated in Chart 4, the average multiple for this size range was just over 38 for Q199. What is particularly surprising about this size category is how consistent market values were for this quarter. Unlike any other segmentation, the range of averages for each region was very small with the lowest average (Northeast and South) just under 38 times RMR and the highest (West) exactly 39 times RMR.

## SECTION TWO - ANALYSIS

## SECURITY ALARM MARKET VALUE WATCH

**Chart 5** indicates that national average values for selling companies with \$100K-\$500K of RMR declined slightly to 43 times RMR. The volume of transactions increased from the prior quarter, but this appears to be in large part due to sellers purposefully delaying the transaction into the 1999 tax year, which also explains the very low volume in Q498. For regionally focused sellers in this size category, prices actually increased slightly. Transactions in this range occurred in the North Central and South regions, with average valuation multiples increased from approximately 45 to 46 in the North Central and from 39 to 40 in the South (See North Central and South region analysis sections). These slight gains were offset by the decline in average prices realized by selling companies of this size that were multi-regional in operation.

Significantly, there were three transactions in Q199 in the largest size category. Entergy sold its alarm operations to ADT (the largest transaction of the quarter), AlarmGuard was similarly acquired by ADT, and Monitronics acquired DMAC. Public information released by Entergy, AlarmGuard and ADT allows for a fairly accurate estimation of the 58 valuation multiple for AlarmGuard and the 52 multiple for Entergy. The DMAC transaction occurred with a relatively lower valuation multiple, with the overall average for this size category of 52 times RMR. These results exhibit a surprising consistency in average values, especially when adjusting for the Wells Fargo deal in Q298. If the low multiple for that deal is removed from consideration, an average multiple of 52 results for that quarter. (See the Spring 1999 issue of this publication.)

#### Residential vs. Commercial

Consistent with prior periods, the market afforded different average valuations depending on the residential or commercial focus of the selling company. As indicated in **Chart 7**, residential oriented operations were valued slightly higher on average than commercial in all size categories other than the largest. Commercial oriented transactions traded at roughly a 5% to 15% discount. This is true in each of the regions of the country except in the Northeast, where commercial companies received higher relative valuations.

In the largest size category, out of the three transactions that occurred in the first quarter, AlarmGuard received the highest valuation and was the only one with a decided commercial orientation to its customer base.

#### Stock vs. Asset Transactions

The AlarmGuard transaction similarly affected the valuation

CHART 7: NATIONAL MULTIPLES PAID BY SIZE, CUSTOMER TYPE

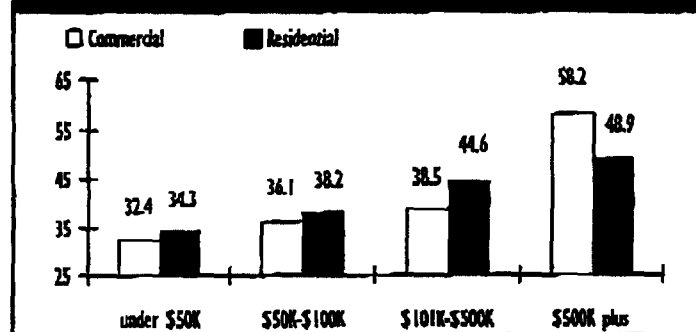


CHART 8: NATIONAL MULTIPLES PAID BY SIZE, TRANSACTION TYPE

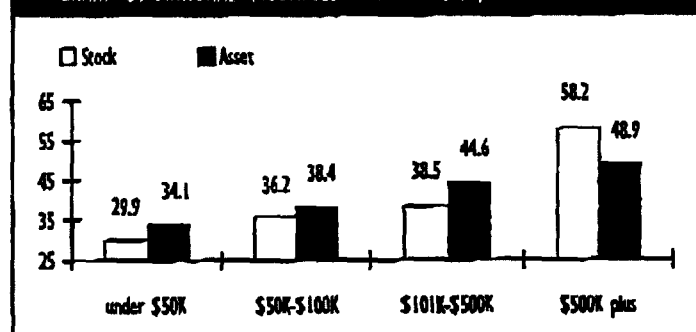
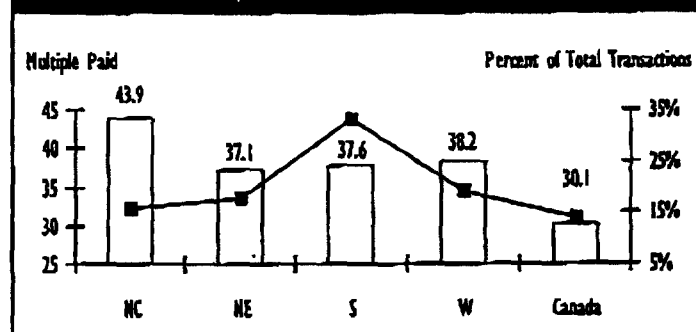


CHART 9: UNDER \$500K RMR - MULTIPLES PAID BY REGION



spread between asset purchase transactions and stock purchase transactions in the largest size category as indicated in **Chart 8**. The tax implications of this structure were clearly not an important overall element in the few transactions in this size range. In the lower size categories, where there were many more transactions and a more homogeneous market the expected spread favoring asset transactions appeared.

Stock purchase transactions traded at roughly a 6% to 14% discount, which acknowledges the typical decrease in tax benefit the buyer can realize in purchasing the shares of a company as

# SECURITY ALARM MARKET VALUE WATCH

PREMIER ISSUE

SPRING 1999

## Doing the Numbers on 1998

### Assessing a potentially pivotal year for market valuations

It was another big year for the security alarm industry. There was a vigorous market for the buying and selling of alarm companies, similar to the landmark year of 1997, but with some early indications that prices and volumes of transactions may decline.

Several of the industry's largest and oldest players decided to take advantage of the high market valuations and sell. Borg-Warner sold Wells Fargo Alarm to ADT in the largest transaction of the year, Westec sold its residential operations to Southern California Edison, Multimedia sold its alarm division to Protection One, and Holmes was acquired by ADT. Just these transactions alone totaled over \$1.5 billion dollars in value, representing a very active year by any measure.

Other factors influencing overall mar-

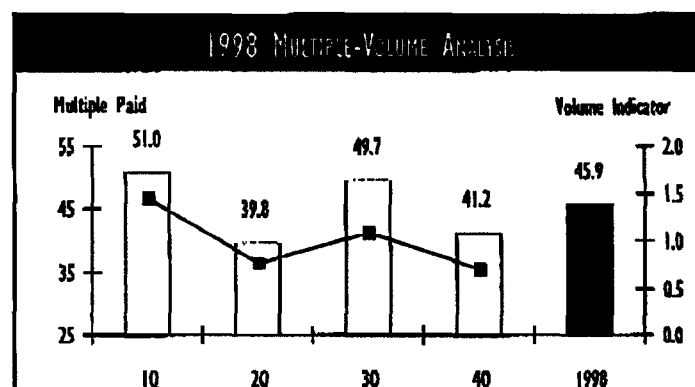
ket conditions were also favorable. In January of this year, *SDM* magazine released revenue figures for 1998 that indicated strong growth in the industry. In addition, the capital markets were generally strong for most security alarm companies. The debt markets in particular supported small- and mid-sized alarm companies. The year also witnessed a rapid acceleration in the growth of dealer program activity.

In spite of these positive indicators and activity, it appears that market valuations may be on the decline. On the surface, this supposition would seem to be supported by the chart shown above, which plots the overall average prices paid as a multiple of RMR and the number of transactions for each of the four quarters of the year. There are also other declining indicators, such as the fairly steady drop (in the midst of a bull market) of public stock values for several of the dedicated industry players, and Ameritech's absence in the larger transaction market.

Upon closer inspection, however, some of these negative indicators have significant mitigating factors. The volume and

prices of the largest transactions for the period, for instance, materially influence the prices and volume shown in the chart below. Excluding these deals, the picture is not so clear. Many market segments, when organized by size of selling company and geography indicated a high degree of price stability in 1998 or, in some cases, had overall increases.

Similarly, Ameritech's lack of acquisi-



tion activity at the higher end of the market may not be permanent. They have continued to show a commitment to their alarm business unit and could easily re-enter the fray... possibly after certain details associated with the Southwestern Bell merger are worked out. It is also important to note that the second largest transaction of the year involved a new entrant, Southern California Edison, whose efforts are headed-up by the same gentleman who oversaw Ameritech's alarm business at the start of its most acquisitive period.

As a result, the stage appears set for the market to go either way. Demand and capital could generally, or selectively, shrink.

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The market could see a consistent decline in valuations. Or, the existing industry players, along with some new entrants, could renew buying activity (and industry consolidation) with the effect of stabilizing and/or increasing prices.

Organized in several distinct sections, this report, the premier issue of *Security Alarm Market Value Watch*, is dedicated to reviewing the market and developing a better understanding of what factors affect values. The first section, *ANALYSIS*, presents market data, prices and transaction

volumes by such indices as the size and geographic location of the seller, the structure of the deal, and customer mix. This section also examines volume, price and terms associated with dealer program activity, which is quickly becoming a significant part of the market.

The *COMMENTARY* section explores key industry issues affecting and concerning the market. This issue examines the validity of using multiples of RMR as an indicator, and an assessment of how low prices can and may go.

In the final section of this report, *PUBLIC COMPANIES*, stocks that are "pure plays" in

the security alarm industry are charted and analyzed.

*Security Alarm Market Value Watch* is a quarterly publication, with the first quarter of 1999 going to press shortly. Each issue will contain the same sections as this, the premier issue. Future plans include adding interviews with people affecting the market, detailed analysis of selected transactions, and broader coverage of the capital markets. This is a work in progress and we are counting on thoughtful feedback. Please contact us at (847) 251-1512 or send an e-mail to [potooole@barnesassociates.com](mailto:potooole@barnesassociates.com).

For over 13 years Barnes Associates Inc. has provided investment banking services to the security alarm industry. Throughout that time there has been a continued need for, and a surprising lack of, detailed information and analysis regarding issues affecting the value of alarm companies and their assets. To specifically address these issues, we have formed Barnes Associates Research & Publishing (BARP). The company will specifically focus on developing and publishing information regarding:

- the market value of alarm companies and their assets;
- the operating dynamic of alarm companies;
- benchmarking operating performance and techniques for analyzing the results; and
- financing and capital market issues.

A quarterly publication dedicated to tracking the trading activity of alarm companies and the issues affecting values, *Security Alarm Market Value Watch* is BARP's first

product. It is specifically designed to provide alarm company owners, investors, and executives with the accurate information necessary to assess the value of their investment and make fundamental decisions regarding continued opportunities within the industry. It also can assist in planning for acquisitions and measuring purchasing performance within the market.

In addition to the compelling current market need for the information we are developing, the timing is very good for us. Our many years of experience and dedication to the industry, combined with the trust we have earned, affords us a unique platform from which to assemble and analyze this information. In addition, we have found the right person for the job of driving this effort. Patrick O'Toole has both the requisite alarm industry background as a former associate editor with *SDM* magazine and prior experience in developing financial analyst reports for an investment banking firm. This is the Premier Issue of *Market Value Watch*. We hope you find it valuable.

### To Our Subscribers:

Michael Barnes